

Rule 17a-11

SUPPORTING STATEMENT

A. Justification

1. Necessity for Information Collection

In response to an operational crisis in the securities industry between 1967 and 1970, the Securities and Exchange Commission (“Commission”) adopted Rule 17a-11 (17 C.F.R. 240.17a-11) under the Securities Exchange Act of 1934 (“Exchange Act”) on July 11, 1971. The Rule requires broker-dealers that are experiencing financial or operational difficulties to provide notice to the Commission, the broker-dealer’s designated examining authority (“DEA”), and the Commodity Futures Trading Commission (“CFTC”) if the broker-dealer is registered with the CFTC as a futures commission merchant. Rule 17a-11 is an integral part of the Commission’s financial responsibility program, which enables the Commission, a broker-dealer’s DEA, and the CFTC to increase surveillance of a broker-dealer experiencing difficulties and to obtain any additional information necessary to gauge the broker-dealer’s financial or operational condition.

Rule 17a-11 also requires over-the-counter (“OTC”) derivatives dealers and broker-dealers that are permitted to compute net capital pursuant to Appendix E to Exchange Act Rule 15c3-1 to notify the Commission when their tentative net capital drops below certain levels. OTC derivatives dealers must also provide notice to the Commission of backtesting exceptions identified pursuant to Appendix F of Rule 15c3-1 (17 C.F.R. 15c3-1f).

The Commission is statutorily authorized to promulgate Rule 17a-11 under Sections 15(c)(3) and 17(a) of the Exchange Act (15 U.S.C. §§78o and 78q). These sections authorize the Commission to provide safeguards with respect to financial responsibility and to request that such records be made and kept as are necessary or appropriate in the public interest. Further statutory authority is found in Section 23(a) of the Act, 15 U.S.C. §78w.

In March 2007, the Commission proposed for comment amendments¹ to its net capital, customer protection, books and records, and notification rules for broker-dealers under the Exchange Act. More specifically, the proposed amendments to Rule 17a-11 would require a broker-dealer to provide notice to the Commission and other regulatory authorities if the broker-dealer becomes subject to certain insolvency events, and notice to the Commission and other regulatory authorities if the broker-dealer’s securities borrowed and loan or securities repurchase/reverse repurchase activity reaches a certain

¹ Exchange Act Release No. 55341 (Feb. 23, 2007), 72 FR 12862 (Mar. 19, 2007).

threshold or, alternatively, provide its DEA with a monthly report of the broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity.²

This supporting statement describes the impact of these proposed amendments on the currently approved inventory for this collection of information, as well as provides revised burden estimates as a result of the proposed amendments to Rule 17a-11 discussed in the 2007 proposing release.³

2. Purpose of, and Consequences of Not Requiring, the Information Collection

The information obtained under Rule 17a-11 is used to monitor the financial and operational condition of a broker-dealer by the Commission staff, by the broker-dealer's DEA, and by the CFTC. This information alerts the Commission, the DEA, and the CFTC of the need to increase surveillance of the broker-dealer's financial and operational condition and to assist the broker-dealer to comply with the Commission's rules. No similar information is already available to use or modify for purposes of complying with Rule 17a-11 because the disclosures required by the rule are unobtainable until the early warning mechanisms or specified thresholds are triggered. Only the most up-to-date information will help the Commission, SROs, and the CFTC to monitor broker-dealers experiencing financial or operational difficulties.

The proposed monthly report related to the broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity may be filed by a broker-dealer in lieu of the filing of the required notice under proposed Rule 17a-11(c)(5). The monthly report is designed to enhance the monitoring of these securities activities by securities regulators.

3. Role of Improved Information Technology and Obstacles to Reducing Burden

Broker-dealers required to provide notice under Rule 17a-11 may give or transmit such notice by telegraphic notice or facsimile transmission. Reports required by Rule 17a-11 may be transmitted by overnight delivery. Certain SROs have developed systems that enable them to receive these notices or proposed monthly report electronically.

4. Efforts to Identify Duplication

Duplication of information is not a concern because the reporting requirements are only applicable to those broker-dealers triggering the early warning mechanisms or specified thresholds of Rule 17a-11.

5. Effects on Small Business or Other Small Entities

² See proposed Rule 17a-11(b)(1) and (c)(5).

³ See *supra* note 1.

To the extent that some broker-dealers that are required to give notice under the Rule, or choose to provide the proposed monthly stock loan/stock borrow report under proposed Rule 17a-11(c)(5) to their DEA, are small entities, the Rule will impact these entities. However, information is collected from small registered broker-dealers only when they are required to provide notice under the Rule, or if they would choose to file the proposed monthly report in lieu of providing notice under proposed Rule 17a-11(c)(5).

6. Consequences of Less Frequent Collection

Only broker-dealers having financial or operational problems or which exceed certain proposed thresholds must give notice under the Rule. Less frequent notification would result in the Commission, SROs, and the CFTC receiving less timely notification of broker-dealers' financial or operational problems.

7. Inconsistencies with Guidelines in 5 CFT 1320.5(d)(2)

The collection of information required by Rule 17a-11 is conducted in a manner consistent with the guidelines in 5 C.F.R. 1320.5(d)(2).

8. Consultations Outside the Agency

All Commission rule proposals are published in the *Federal Register* for public comment. The comment period for the proposing release that discusses the proposed amendments to Rule 17a-11 was 60 days.⁴ This comment period afforded the public an opportunity to respond to the proposal. No PRA comments were received in response to this request.

9. Payment or Gift to Respondents

Not applicable.

10. Assurances of Confidentiality

The Commission will generally not publish or make available to any person notices or reports received pursuant to Rule 17a-11. The Commission believes that information obtained under Rule 17a-11 relates to a condition report prepared for the use of the Commission, other federal governmental authorities, and securities industry SROs responsible for the regulation or supervision of financial institutions.

11. Sensitive Questions

No questions of a sensitive nature are asked by Rule 17a-11.

⁴ Exchange Act Release No. 55341 (Feb. 23, 2007), 72 FR 12862 (Mar. 19, 2007).

12. Estimate of Respondent Reporting Burden

Under Rule 17a-11, only broker-dealers whose capital declines below certain specified levels or who are otherwise experiencing financial or operational problems have a reporting burden under Rule 17a-11. In 2008, the Commission received approximately 400 notices under this Rule. The Commission did not receive any Rule 17a-11 notices from OTC derivatives dealers or broker-dealers that are permitted to compute net capital pursuant to Appendix E to Exchange Act Rule 15c3-1. The Commission estimates that each broker-dealer reporting pursuant to current Rule 17a-11 will spend approximately one hour preparing and transmitting the notice required by the Rule for an annual hour burden of 400 hours (400 notices x 1 hour per notice).⁵

Under the 2007 proposing release,⁶ the proposed amendments to Rule 17a-11 would require a broker-dealer to provide notice to the Commission and other regulatory authorities if the broker-dealer becomes subject to certain insolvency events, and notice to the Commission and other regulatory authorities if the broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity reaches a certain threshold or, alternatively, provide its DEA with a monthly report of the broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity.⁷

The notice requirements under the proposed amendments would result in irregular filings from a small number of broker-dealers. SIPC's 2005 annual report indicates that in recent years an average of six broker-dealers per year have become subject to a liquidation proceeding under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa *et seq.*) ("SIPA"). Accordingly, the Commission estimates that approximately six insolvency notices would be sent per year and that a broker-dealer would spend, on average, approximately ten minutes of employee resources to prepare and send the notice. Therefore, the Commission estimates that the total annual burden to the industry arising from the proposed amendment to Rule 17a-11(b)(1) would be approximately one hour.⁸

As discussed in the 2007 proposing release,⁹ based on FOCUS Report filings, the Commission estimates that approximately twelve stock loan/borrow notices would be sent per year under the proposed amendment to Rule 17a-11(c)(5). The Commission further estimates that a broker-dealer would spend, on average, approximately ten minutes of employee resources to prepare and send the notice. Therefore, the

⁵ The estimate of respondent reporting burden discussed in this Item 12 consists of: (1) currently approved hours contained in this "collection of information"; plus (2) proposed changes in the hour burdens due to the proposed amendments to Rule 17a-11 discussed in the 2007 proposing release. *See supra* note 1.

⁶ *See supra* note 1.

⁷ *See* proposed Rule 17a-11(b)(1) and (c)(5).

⁸ 6 notices x 10 minutes per notice = 1 hour.

⁹ *See supra* note 1.

Commission estimates that the total annual hour burden to the industry arising from filing a notice under proposed Rule 17a-11(c)(5) would be approximately two hours.¹⁰

As discussed in the 2007 proposing release,¹¹ based on FOCUS Report filings, the Commission estimates that 21 broker-dealers per year would submit the monthly stock loan/borrow report in lieu of filing a notice under proposed Rule 17a-11(c)(5). The Commission estimates each firm would spend, on average, approximately 100 hours of employee resources updating its systems to generate the report. Therefore, the Commission estimates that the total one-time burden to the industry arising from this proposed requirement would be approximately 2,100 hours.¹² As for annual burden, the Commission estimates each firm would spend, on average, approximately one hour per month (or twelve hours per year) of employee resources to prepare and send the report. Therefore, the Commission estimates the total annual burden arising from filing a monthly report under proposed Rule 17a-11(c)(5) would be approximately 252 hours.¹³

13. Estimate of Total Annualized Cost Burden

The Rule does not impose any costs other than costs associated with the burden described in Item 12 above.

14. Estimate of Cost to Federal Government

The annual operational costs incurred by the federal government in enforcing compliance and reviewing the notices required by Rule 17a-11 amount to approximately \$7,843. This amount is based upon the calculation of the value of 166 hours of staff time devoted to these activities, plus the related overhead expenses. These estimates have been computed based on the GSA, Guide to Estimating Report Costs (1986).

15. Explanation of Changes in Burden

The changes in the reporting burden are a result of the proposed amendments to paragraphs (b)(1) and (c)(5) to Rule 17a-11.¹⁴

16. Information Collection Planned for Statistical Purposes

¹⁰ 12 notices x 10 minutes per notice = 2 hours.

¹¹ See *supra* note 1.

¹² 21 broker-dealers x 100 hours per firm = 2,100 hours.

¹³ 21 broker-dealers x 12 hours per year or 252 hours.

¹⁴ See *supra* note 1.

This provision is not applicable because compliance with Rule 17a-11 will not require the employment of statistical methods. There is no intention to publish the information for any purpose.

17. Explanation as to Why Expiration Date Will Not Be Displayed

Not applicable.

B. Collection of Information Employing Statistical Methods

Not applicable.